Maine Revenue Services
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Guidance Document

Pine Tree Development Zone Income Tax Credit, Franchise Tax Credit & Insurance Premiums Tax Credit

Instructions for Calculating the Income Tax Credit for Qualified Pine Tree Development Zone Businesses

Rev 11/05

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INTRODUCTION

The Pine Tree Development Zone ("PTDZ") income tax credit is available to certified businesses engaged in qualified activity for tax years beginning on or after January 1, 2004. The credit is available to all businesses (corporations, pass-through entities, or sole proprietorships) certified by the Department of Economic and Community Development ("DECD"). To obtain certification, the business must apply to DECD and meet the requirements for qualified business activity.

Generally, in order to qualify, a business must be engaged in manufacturing, financial services, biotechnology, aquaculture and marine technology, composite materials technology, environmental technology, advanced technologies for forestry and agriculture, information technology or precision manufacturing technology. Further, a business engaged in one of the aforementioned activities must hire at least one qualified employee for work in one of the areas in Maine designated as a Pine Tree Development Zone.

To gain certification, the business must apply to DECD. Applications are available online at: *www.mainebiz.org/why_maine/pine_tree_zones.asp*. This address also provides links to the statute, the DECD Pine Tree Development Zone Rule and other useful information.

Certified businesses must file an annul report with DECD. The Department of Economic and Community Development will review these reports and any other required information and determine if the business continues to meet the requirements for a "qualified Pine Tree Development Zone business."

1. Determination of Credit Amount

The credit is based on the Maine tax liability related to income from qualified PTDZ business activity. Qualified business activity ("QBA") is determined by DECD (*See* 30-A M.R.S.A. chapter 206, subchapter 4 and DECD Rule 19-100, Chapter 100). For the first 5 years, the credit is equal to 100% of the tax liability; for the next 5 years it is equal to 50% of the tax liability. Certified business entities that have both qualified and non-qualified business activity are allowed a credit for only a portion of the total tax liability. To determine the percentage of tax that is allowed as a credit, the business must divide the value of property used and payroll paid during the year that was related to qualified activity by the total value of all Maine property used and Maine payroll paid in the year. This process is also called apportionment and is described in detail in Section 3. The credit percentage is then applied against the total tax liability to determine the dollar amount of the credit. (See credit application worksheet).

The program is not intended to provide tax benefits for simply shifting already existing Maine business activity – either from outside a PTDZ location to inside a PTDZ location, or within the PTDZ from existing business activity to the new certified facility in the PTDZ. Therefore, property and payroll that has been transferred to the qualified business activity must be eliminated from the numerator of the apportionment calculation. Likewise, property and payroll associated with the qualified business activity prior to certification must not be included in the numerator of the apportionment calculation. Payroll for employees hired during the year of certification, but prior to the actual certification date, is included in the numerator of the apportionment calculation. This is true for all "net new" employees, whether or not they are qualified for PTDZ or Employment Tax Increment Financing ("ETIF") purposes.

If the apportionment calculation does not fairly reflect the fraction of a business' activity that is qualified business activity, the business may request, or the State Tax Assessor may require, an alternate method of calculating the income tax credit (see section 3).

Once certified, a business may be able to claim the income tax credit for ten years, beginning with the year in which the business is certified.

2. Priority of PTDZ Credit over other Credits

Because the credit is based on tax liability in a given tax year, there is no provision for carrying the credit forward to future years. Taxpayers, however, may apply the PTDZ credit against tax liability before utilizing any other available credit. For example, if a taxpayer has current year Maine tax liability of $100,000, a PTDZ credit of 75% of liability ($75,000), and a High Technology credit of $50,000 (which may be carried forward 5 years), the taxpayer can reduce tax liability by $75,000 with the PTDZ credit, and then reduce the remaining tax liability to zero by applying $25,000 of the $50,000 High Technology credit. The remaining $25,000 in High Technology credit may be carried forward.

3. Credit Apportionment

The apportionment statute appears in Title 36, section 5219-W (and section 2529 for insurance premiums), as follows:

> **2. Apportioned credit in certain circumstances.** In the case of a qualified Pine Tree Development Zone business as defined in Title 30-A, section 5250-I, subsection 17 that engages in both qualified and nonqualified business activities in this State, the credit provided for in this section is limited to that portion that is attributable to the qualified business activity. The limitation is calculated by an apportionment. The apportionment is determined by a fraction, the numerator of which is the property value plus the payroll for the taxable year attributed to the qualified business activity of the business and the denominator of which is the statewide property value plus payroll for the taxable year of the business.
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> If the qualified business is a taxable corporation that has affiliated groups, as defined in section 5102, subsection 1-B, engaged in a unitary business, as defined in section 5102, subsection 10-A, the property and payroll values in the State of the unitary affiliated groups must be included in the apportionment fraction. The resulting fraction must be multiplied by the total tax liability otherwise due under this Part of the qualified business and those affiliated groups.
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> If the apportionment provisions of this subsection do not fairly reflect the amount of the credit associated with the taxpayer's qualified business activity, the taxpayer may petition for, or the State Tax Assessor may require, in respect to all or any part of the taxpayer's business activity, the employment of another reasonable method to effectuate an equitable apportionment of the credit associated with the taxpayer's qualified business activity.

Qualified business activity means only the activity associated with the expansion or initial business creation for which the entity has been certified by DECD (*see* 30-A M.R.S.A. § 5250-I(16) & (17)). Therefore, a taxpayer that has business income from both PTDZ qualified business activity and non-qualified business activity is allowed a tax credit for the tax associated with only the income generated by the qualified business activity. To ensure that the income tax credit is based only on the expansion activity in the PTDZ, the numerator of the apportionment factor may not include transferred property, employees and positions. Likewise, the value of Maine property that is sold must be subtracted from the property value in the numerator. The sale of non-PTDZ Maine property combined with the purchase of PTDZ property represents a transfer of property and must, therefore be discounted from the calculation of the income tax credit. The determination of property values and payroll generally follows the methods and definitions that are used for multistate corporate income tax apportionment under 36 M.R.S.A. § 5210-11 and MRS Rule 801.06 and .07.

Apportionment Factor. The apportion factor is a fraction used to calculate the ratio of qualified to non-qualified business. The numerator of the apportionment factor is the value of the taxpayer's property attributed to a qualified business activity during the taxable year plus the payroll during the tax year attributed to a qualified business activity. The denominator of the apportionment factor is the total value of all the taxpayer's property used during the tax year in Maine plus the total payroll for all Maine employees during the tax year. A business may not include in the numerator property or payroll related to transfers to the zone from elsewhere in Maine (*see* 30-A M.R.S.A. §§ 5250-J(3)(C) & (D)).

A. Property. The term "property" means the average value of the taxpayer's real and tangible personal property owned or rented and used during the tax period. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer.

B. Property Used During the Taxable Year. Maine property is included in the apportionment factor if it is actually used or is available for or capable of being used during the tax period by the taxpayer. Property located in Maine and held in reserve or standby facilities or property held as a reserve source of materials must be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor. Property or equipment under construction during the tax period (except inventoriable goods in process) must be excluded from the factor until such property is actually used in Maine by the taxpayer. If the property is partially used by the taxpayer while under construction, the value of the property to the extent used must be included in the apportionment factor. Property used by the taxpayer must remain in the apportionment factor until its permanent withdrawal is established by an identifiable event such as its sale, or the lapse of an extended period of time (normally, five years) during which the property is held for sale.

C. Property in transit/Mobile property. Property in transit between locations of the taxpayer to which it belongs is considered to be located at the destination for purposes of the apportionment factor. Property in transit between a buyer and seller that is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices may be included in the numerator according to the destination (PTDZ or non-PTDZ).

D. Valuation (owned property). Property owned by the taxpayer is valued at its original cost. "Original cost" means the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, etc. However, capitalized intangible drilling and development costs are included in the factor whether or not they have been expensed for either federal or state tax purposes. If the original cost cannot be ascertained, the property must be included in the factor at its fair market value as of the date of its acquisition by the taxpayer.

Generally, the average value of property owned by the taxpayer is determined by averaging the values at the beginning and ending of the tax period. However, the State Tax Assessor may require or allow averaging of monthly values if substantial fluctuations in the values of the property exist during the taxable year or if property is acquired after the beginning of the taxable year or disposed of before the end of the taxable year.

E. Valuation (rented property). Property rented by the taxpayer is valued at eight times the net annual rental rate. Subrentals are not deducted. If property is used at no charge or rented for a rate other than a reasonable market rate, the property must be included in the apportionment factor on the basis of a reasonable market rental rate. The "annual rental rate" is the amount paid as rent for the property for a twelve-month period. Where property is rented for less than a twelve-month period, the net rent paid for the actual period of rental constitutes the "annual rental rate" for the tax period. However, where a taxpayer has rented property for a term of 12 or more months and the current tax period covers a period of less than 12 months, the net rent paid for the short tax period must be annualized. If the rental term is for less than 12 months, the rent must not be annualized beyond its term. Rent will not be annualized because of the uncertain duration when the rental term is on a month-to- month basis. "Rent" is the actual sum of money or other consideration payable directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:

> **(1)** Any amount payable for the use of real or tangible personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise;
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> **(2)** Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items required to be paid by the terms of the lease or other arrangement but does not include amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent must be determined by consideration of the relative values of the rent and the other items.

"Rent" does not include incidental day-to-day expenses such as hotel or motel accommodations, daily rental of automobiles, etc. "Rent" does not include royalties based on extraction of natural resources, whether represented by delivery or purchase. For this purpose, a royalty includes any consideration conveyed or credited to a holder of an interest in property which constitutes a sharing of current or future production of natural resources from such property, irrespective of the method of payment or how such consideration may be characterized, whether as a royalty, advance royalty, rental or otherwise. Leasehold improvements are treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or of whether the improvements revert to the lessor upon expiration of the lease.

F. Effect of Accounting Method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued will be deemed to have been paid. However, compensation may be included in the apportionment factor by use of the cash method if the taxpayer is required to report such compensation under that method for unemployment compensation purposes.

G. Payroll. The term "payroll" means the total amount paid in this State during the tax period by the taxpayer for compensation, including wages, pretax employee contributions made to a benefit package and employer contributions made to an employee benefit package.

H. Employee. "Employee" means any officer of a corporation, or any individual who would be considered an employee under the common law rules governing the employer/employee relationship. Generally, an individual is considered to be an employee if the individual is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act. This presumption may be overcome by evidence provided by a taxpayer that an individual who is included as an employee for purposes of the Insurance Contributions Act would not be an employee of the taxpayer under the usual common-law rules.

I. Independent Contractor. “Independent contractor” means any individual who performs services for a taxpayer but who is not an employee of the taxpayer, and who is not otherwise subject to the supervision or control of the taxpayer in the performance of the services. Independent contractors are not considered qualified employees for PTDZ or ETIF purposes, but wages paid to independent contractors is includible in the numerator of the income tax apportionment factor if such workers are “net new” above the base level of employment.

J. Affiliated Businesses. The total property and payroll values of affiliated businesses engaged in a unitary activity must be included in the apportionment calculation. An “affiliated business” means “a member of a group of 2 or more businesses in which more than 50% of the voting stock of each member corporation . . . is directly or indirectly owned by a common owner or owners.” 30-A M.R.S.A. § 5250-I(1). The affiliated business group used for credit apportionment purposes is the same group that is required to file a combined report for corporate income tax purposes. The numerator of the apportionment calculation includes all new property and payroll located in the zone and used in a qualified business activity (net of in-state transfers, including transfers between affiliated businesses) and the denominator includes all Maine property and payroll for the taxpayer and all affiliated businesses.

K. Payroll for leased and temporary employees. Payroll in the apportionment factor must include 85% of amounts paid to an employee-leasing company for leased employees in Maine and 100% of amounts paid for temporary employees in Maine. Leased and temporary employees are not includible as qualified employees for purposes of the PTDZ or ETIF, but the payroll for those leased or temporary employees in excess of the base level of employment may be added to the numerator of the income tax credit apportionment calculation.

4. Partners/Members of Pass-through Entities.

For shareholders of S corporations and partners in a partnership, including members of an LLC that is treated as a disregarded entity for federal tax purposes, tax credits attributable to PTDZ qualified businesses are determined at the individual taxpayer level (or at the corporate level for corporations that are partners in a partnership). That is, the tax credit amount is based on the tax liability that is attributed to PTDZ income earned by, or distributed to, the taxpayer by the business entity.

The business entity must first determine the PTDZ credit percentage through the apportionment calculation as described above. The entity must then allocate income to its owners, shareholders, partners or members, according to their distributive share or ownership interest. The owners, shareholders, partners or members, who have income in addition to PTDZ qualified business income must then calculate the percentage of their taxable income that is attributable to the total income that is distributed by the business entity. The income from the PTDZ business as adjusted for federal purposes and modified for Maine purposes is divided by the total Maine adjusted gross income for individuals (*see* Maine Form 1040, line 16) or total adjusted federal taxable income for corporate partners (*see* Maine Form 1120, line 5). This income ratio is multiplied by the PTDZ credit percentage as calculated by the entity. The result is the percentage of total income tax that the taxpayer may claim as a credit. (*See* examples 7 and 8 in the next section for illustrations of this calculation.)

5. Examples of Apportionment

In all the following examples, it is assumed that all expansion property and payroll is 100% qualified. The following example illustrates the available tax credit under varying circumstances.

Example #1 – A new business opens in a PTDZ

Corporation A: startup business inside a PTDZ
Corporation A applies for and receives certification as a PTDZ business and then commences qualified business activities. The application provides for investment in $200,000 of property and $200,000 of payroll. Since all of Corporation A's business activity is qualified, it receives a 100% income tax credit.

The following two examples illustrate the available tax credit for two identical businesses, one located initially outside a PTDZ, but inside Maine and one located in a PTDZ.

Example #2 – A Maine business located outside a PTDZ expands inside a PTDZ.

Corporation B: located in Maine, outside any PTDZ
Existing facilities: $1,000,000 property; $1,000,000 payroll
Corporation B applies for and receives certification for expanding into a PTDZ and engages in qualified business activity. The expansion includes $200,000 of property and $200,000 of payroll for total Maine property of $1,200,000 and Maine payroll of $1,200,000. Since Corporation B operates in Maine outside a PTDZ, the income tax credit must be apportioned as follows:
($200,000 + $200,000)/($1,200,000 + $1,200,000) = 16.67%

Corporation B's PTDZ income tax credit equals 16.67% of its total Maine tax liability, which reflects the tax liability associated with the income from the expansion.

Example #3 – Expansion of an existing business located in a PTDZ.

Corporation C: located in Maine, in an area that is designated as a PTDZ. Corporation C starts with the same amount of existing property ($1,000,000) and existing payroll ($1,000,000) as Corporation B in the previous example. Corporation C applies for and receives certification as a PTDZ business and engages in qualified business activity. Corporation C, like Corporation B (*see* example #2), invests $200,000 in additional property and $200,000 in additional payroll.

Corporation C's income tax credit, like Corporation B's, is based on 16.67% of its total Maine tax liability.

The following example illustrates the credit allowed a business with two Maine locations prior to expansion, one within a PTDZ and one outside.

Example #4 – Expansion of an existing business with operations both inside and outside a PTDZ

Corporation D: located in Maine in two sites, one of which is designated a PTDZ. The facts are the same as with Example #3, except placement of the initial property and payroll. Corporation D starts with $500,000 of property and $500,000 of payroll in a PTDZ and $500,000 of property and $500,000 of payroll in its non-PTDZ Maine location. Expansion in the PTDZ equals the $400,000 described in Example #3. Corporation D now has $700,000 of property and $700,000 of payroll inside the PTDZ and $500,000 of property and $500,000 of payroll outside the PTDZ. Corporation D, like Corporations B and C, will also base its credit on 16.7% of its Maine tax liability.

Example #5 – A non-PTDZ Maine business expands into a PTDZ and also transfers property and payroll

Business A exists in Maine, in a non-PTDZ location. Current property and payroll are $500,000 each. Business A, certified by DECD, expands its operations into a PTDZ and begins qualified activity. Business A transfers $100,000 of property and $100,000 of payroll from the existing location into the PTDZ and invests in an additional $300,000 of property and $300,000 of payroll. After investment, the business operations are distributed as follows:

	PTDZ	Non-PTDZ
Property	$400,000	$400,000
Payroll	400,000	400,000
Total	$800,000	$800,000

At first glance, it appears as though Business A should receive a 50% income tax credit, since half of its operations are located in a PTDZ and half are located outside the zone. However, since some property and payroll were transferred to the PTDZ, the numerator of the apportionment calculation must be adjusted by subtracting out the value of the transferred property and payroll. After elimination of the transfers, the calculation looks like this:

($300,000 + $300,000)/($800,000 + $800,000) = $600,000/$1,600,000 = 0.375 or 37.5%

The percentage of Business A's credit is 37.5% of its Maine tax liability.

Example #6 – A non-PTDZ business with an affiliate expands into a PTDZ and also transfers property and payroll

Assume the same facts as in example #5, except that Business A also owns Business B. Business B has $100,000 of property and $100,000 of payroll, all in Maine, but not in a PTDZ. Business A will have to include all of Business B's payroll and property in the apportionment denominator. Business A's apportionment percentage now looks like this:

($300,000 + $300,000)/($900,000 + $900,000) = $600,000/$1,800,000 = 0.333 or 33.3%

Business A will get a credit for 33.3% of the combined Maine income tax liability of Business A and Business B.

Example #7 – Individual member of a pass-through entity

Individual A is a 50% owner of S corporation #1 that qualifies for a 100% PTDZ credit. Individual A has $30,000 of income from S corporation #1 and $40,000 of income from other sources. Individual A has no federal adjustments or Maine modifications. S corporation #1 passes 100% of the income tax credit to its shareholders, including Individual A. Individual A then calculates his/her apportionment factor as follows:

Credit from S corporation #1 = 100% of Maine tax liability related to S corporation #1 income.

Apportionment = Individual A's income from S corporation #1/ Individual A's total Maine adjusted gross income
= $30,000/($30,000 + $40,000) = $30,000/$70,000 = 0.4286 or 42.86%

Individual A may claim 42.86% of his/her total Maine income tax liability for the year as a credit.